

Monthly Interest

Understanding AWP

Average Wholesale Price (AWP) is perhaps the most misunderstood concept in the pharmaceutical industry. The purpose of this article is to describe what is meant by AWP and to explain some of the underlying concepts involved in the acquisition, determination and maintenance of First DataBank's AWP.

AWP represents an average price which a wholesaler would charge a pharmacy for a particular product. The operative word is *average*. AWP never means that every purchase of that product will be exactly at that price. There are many factors involved in pricing at the wholesale level which can modify the prices charged even among a group of customers from the same wholesaler. AWP was developed because there had to be some price which all parties could agree upon if machine processing was to be possible.

At First DataBank, all pricing information is received in hard copy from the manufacturers. Catalogs, price updates, and other information reach us by fax, Federal Express, or U.S. mail. In the past two years, fax transmission has streamlined the acquisition of data to a large extent.

First DataBank has established specific contact people within each major drug manufacturer/labeler's organization. When pricing or other questions arise, we know who to ask for reliable information. Knowing who to talk to prevents misinformation and keeps problems to a

minimum. Usually it is our contact people who send information to us when there are price changes or other product changes. We make sure that we are placed on the priority mailing list so that we receive the information before the trade. Because personnel movement within a corporation is the norm, we continually work to keep our contact list current.

Once the information is received, we often have to interpret what the data represents. There can be confusing or contradictory factors, not to mention hard to read fax's and typographical errors. Our data entry experts have experience as pharmacy technicians or in related fields. With their knowledge and proficiency, potential errors are detected before they become part of the database. As an example, occasionally a manufacturer which normally sends us wholesale net pricing will inadvertently send direct or suggested list prices. It is up to the staff to recognize the error and ask the manufacturer to send the correct information.

The pricing information which we receive can be in the form of wholesale net, direct, or suggested wholesale prices (see Figure 1). It is our task to convert these prices into AWP. There are several ways in which AWP's are derived. Large manufacturers such as Merck have a one price policy for all purchasers whether wholesale or direct. They supply their published direct prices to which we must determine a markup factor and arrive at an AWP. Others supply wholesale net prices

How Drugs are Purchased

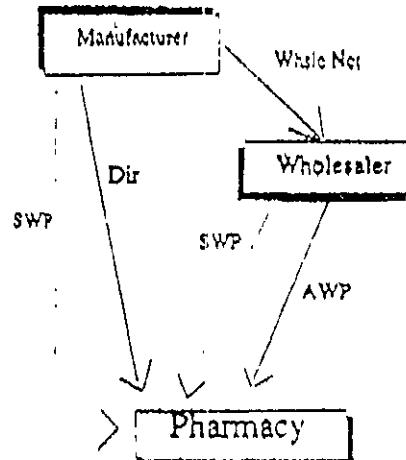


Figure 1

only. In order to determine an appropriate markup, it is necessary to survey wholesalers. The accompanying sidebar (see next page) describes this process in detail. Wholesaler surveys are an important part of what First DataBank does to establish realistic AWP pricing.

Some manufacturers do not sell products through wholesalers but supply a suggested wholesale price, which is

(continued on page 2)

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regarded as the AWP. Others apply different markup factors to each product or type of product and supply suggested wholesale prices which wholesalers use as their AWP. Many generic suppliers fall into this category (see Figure 2).

Maintenance of pricing is perhaps the most challenging task of all. It is

Wholesaler Surveys

First DataBank recognizes that the pharmaceutical industry is constantly evolving. New companies and new products are introduced almost daily. We understand that when product distribution changes within or between manufacturers, wholesaler pricing structures may change. These industry changes have made the wholesaler survey fundamental in maintaining current pricing data.

At First DataBank, wholesaler surveys are done for two reasons: to establish an Average Wholesale Price (AWP) markup for a new company that does not provide a Suggested Wholesale Price (SWP), or to confirm that the markup that First DataBank utilizes for AWP is representative of the wholesaler industry. A survey may be performed on a single NDC number or for a manufacturer's entire line of products. In either case, each wholesaler is surveyed on a number of products within each manufacturer.

The number of surveys performed is increasing. First DataBank surveys at minimum five drug wholesalers that represent over two-thirds of the total dollar volume of drug wholesalers. The markup that First DataBank utilizes is representative of wholesalers on a national level. Because individual wholesalers may mark up each manufacturer differently, a weighted average, not a consensus average, is calculated. That is, the market share held by the wholesalers surveyed affects the markup proportionally. Wholesalers with higher drug dollar volumes have more weight in the determination of the final markup. Thus, a higher degree of certainty is achieved.

In most cases, the results from surveys match what First DataBank is using. In the instances that they do not, it is policy that First DataBank will change the markup on file to report marketplace reality.

Elst DataBase "AWP" Calculation Process

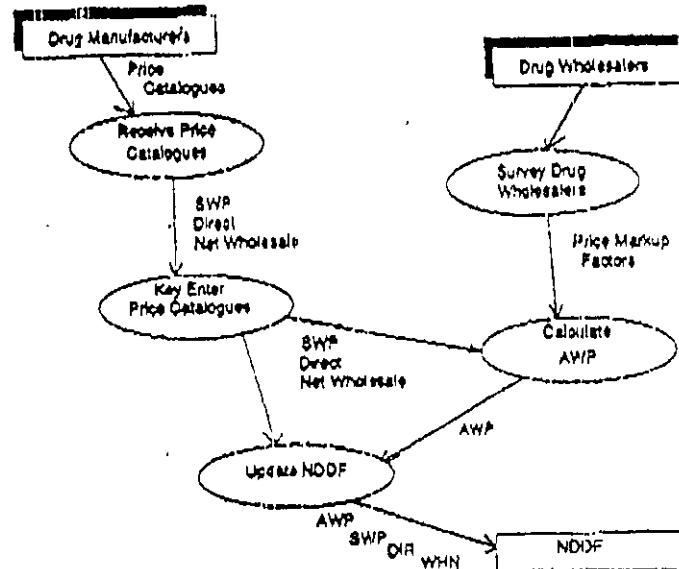


Figure 2

necessary to constantly remind manufacturers that their pricing data must be supplied on time. With the advent of on-line claims processing, pricing must be there when the update occurs. Some manufacturers do not release their price updates until the effective date so that purchasers cannot take the opportunity of purchasing at the old price just before the increase. We have made an all-out effort to apprise the manufacturers of our deadlines so that they do not miss the monthly schedule. We are beginning to see results in this effort.

Data acquisition is a difficult, exacting task which requires constant vigilance. Reporting AWP is an important function of First DataBank and we take this responsibility seriously.

Price Declines And Balance Sheets

Although the expected movement of AWP's is upward, there is an occasional decline without a corresponding change in wholesale net or direct prices. Such an occurrence

usually results when two companies merge into a single entity. Seeking to merge two pricing methods into a unified whole, some products exhibit an AWP drop.

Pharmacies holding inventories of these products had expected to sell their inventory based on current or future AWP. Consequently, when billing third parties at AWP, the stock on hand will produce less profit than expected.

The accounting method most commonly used is to carry inventory at the lower of cost or market value. The selling price does not enter into the picture until the product is actually sold. If the selling price decreases below actual cost, then the carrying value drops correspondingly. Conversely, if the selling price does not decrease below actual cost, then the carrying value does not drop, but the effects are felt in future cash flow and profitability.

As long as mergers and acquisitions continue in the pharmaceutical industry, we can expect occasional AWP decreases.

Reality and AWP

If you were ever confused by the AWP for the product Corgard you are not alone. AWP pricing is an increasingly confusing business, and it's especially so when a particular product's AWP does not behave as expected. Unfortunately, non-standard pricing in the pharmaceutical industry is becoming the norm. The following examples will clarify some of these issues.

The confusion often originates from the current atmosphere of frequent mergers and acquisitions in the pharmaceutical industry. When two companies merge, the pricing philosophy of the larger becomes dominant. Product swapping and habitual changes in marketing strategies - what has been called the 'blending' of the industry - further complicate the situation.

Let's go back to the example of Corgard which this article opened with. Last year Bristol-Meyers acquired Squibb, which manufactures Corgard. The new entity, Bristol-Meyers Squibb, moved Corgard (along with Corzide) to the Bristol Labs line of products. First DataBank responded by revising the AWP's to reflect the accepted Bristol Labs' markup. (See page one for a discussion of markups.)

However, Corgard still has an NDC number recognizable in the industry as a Squibb product, i.e. it has a labeler code of 00003. Although the distributor changed, and thus the AWP, the NDC number remained the same. Since any particular labeler code is no longer strictly associated with only one distributor, two products with the same labeler may have AWP's calculated from totally different markups.

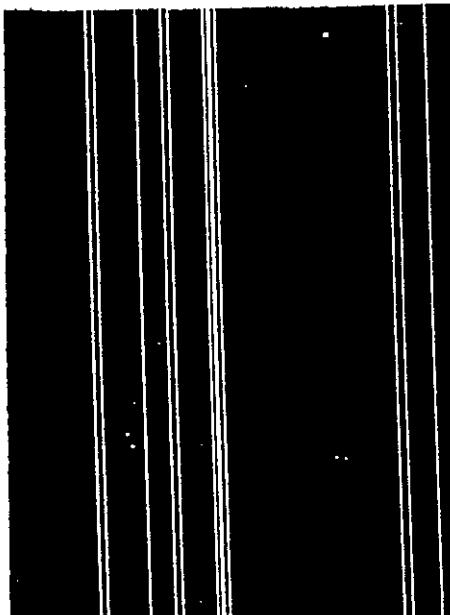
Although the occasional

wholesaler may still be treating these drugs as Squibb products, this is the exception. First DataBank always publishes the surveyed AWP.

Capoten, Prolixin and Rauzide, among other products in the U.S. Squibb Group, recently exemplified another type of pricing change. This division of Squibb introduced prices to the wholesalers where previously only direct pricing was available. After thoroughly researching wholesalers' responses, we instituted a new markup procedure. We were careful to include every product affected in order to minimize the occurrences of pricing changes.

In some cases the reason behind such a change may be invisible to someone who sees only the results. In other cases a new Manufacturer Name or a change to the Labeler Identifier field provides the key. Regardless, there is much consideration to ensure that the AWP reflects reality.

Bob Matutat Promoted to Manager of Professional Services



Bob Matutat has been promoted to Manager of the Professional Services Department. His new responsibilities include overseeing the creation and maintenance of all NDDFTM, MDF, clinical, DUR and Canadian products. He will also continue his involvement in the implementation and modification of all products in order to ensure that the customers requirements are being met at the clinical level.

Bob graduated from the University of California, Berkeley with a B.A. in Political Science, received his Doctorate at the UCSF School of Pharmacy and completed a hospital pharmacy residency at the University of Illinois Medical Center, Chicago. In addition, Bob has 10 years of hospital experience at two major medical centers including three years in drug information and four years in a clinical pharmacy position. He joined First DataBank in November of 1987 as Staff Pharmacist, Professional.

We congratulate Bob on his advancement and achievement, and look forward to watching his future successes.

Arkansas Medicaid

Arkansas Prior Authorization (AR*PA) is now available. Definitions are as follows:

0 = Prior authorization is not required
1 = Prior authorization is required

Colorado Medicaid

Colorado Prior Authorization will be changed from 0-2 definitions to 0-3 definitions. The new PA code is:

3 = Prior authorization is required if drug is dispensed through an outpatient pharmacy.